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Convergence Patterns in Accounting Regulation: Six Country Cases of the Transforming Regulatory Landscape

Jochen Zimmermann
Jan-Philipp Kilian
Johannes Schymczyk

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Universität Bremen • University of Bremen
Jacobs Universität Bremen • Jacobs University Bremen
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Universität Bremen
Sonderforschungsbereich 597 / Collaborative Research Center 597
Staatlichkeit im Wandel / Transformations of the State
Postfach 33 04 40
D - 28334 Bremen
Tel.:+ 49 421 218-8720
Fax:+ 49 421 218-8721
Homepage: http://www.staatlichkeit.uni-bremen.de

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ABSTRACT

This paper inquires into recent changes of accounting regulation in six OECD countries: Germany, France, England, USA, Canada and Japan. Having formerly been embedded into different institutional environments, accounting systems varied widely in the heyday of the interventionist nation state. Since then, international harmonisation has been transforming national accounting systems, leading to increasing convergence between the various systems. It is the aim of this paper to describe these changes systematically, estimate the degree of international convergence and assess how different institutional origins affect convergence patterns. We develop a framework for comparing accounting systems and identify four criteria that describe the anatomy of a national accounting system: (1) Predominant uses of accounting, (2) Extent of professional self-regulation, (3) Legal backing and (4) Degree of internationalisation. Our findings indicate that global convergence in accounting regulation exists, although limited variations between nation states still remain and depend upon the prevailing national institutional arrangements, which have not (yet) converged.

CONTENTS

Convergence patterns in accounting regulation: Six country cases of the transforming regulatory landscape

1 Introduction

In recent years, accounting regulation has undergone significant changes. Most remarkably, international accounting and auditing standards have been developed and are being increasingly applied around the world and especially in the European Union (EU). Further examples of transformations include the creation of public oversight bodies in response to business scandals and serious auditing failures and the fact that company audits are increasingly performed by a small number of international auditing firms, which probably have high lobbying power in the standard-setting processes. Even though these and other changes have been identified and described in previous articles (Naumann 2001; Fearnley and Sunder 2006), they have not been seen in the context of the transformations in the regulatory landscape of financial reporting. In this landscape, two developments are particularly remarkable: First, there is a tendency towards more international solutions (e.g., joint standard-setting projects between the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB)). Second, there is more involvement of private actors (e.g., the IASB getting an important private standard setter in the European Union). Meanwhile, there exist a number of forces impeding the complete and immediate convergence of accounting regulation models. These barriers to harmonisation stem from international divergence in regulatory arrangements, where function, codification and institutional construction of accounting widely vary between countries. The aim of this paper is to illustrate these developments by comparing changing patterns of accounting regulation in six countries. We developed a framework of four criteria to identify changes in relevant areas of the national accounting system.

The country sample applied consists of three EU member states: Germany, France and the United Kingdom; and three non-EU member states: United States, Canada and Japan. The countries were chosen for several reasons: First, all countries have large economies and are, thus, important in their own right. Second, European legislation largely influences the accounting regulation in its member states, which encourages convergence in accounting regulation. However, convergence has not been achieved in reality and the harmonisation within the EU actually resembles the paths of convergence in non-European countries. Third, the six countries traditionally displayed different business (and legal) systems, which can be characterised as following an insider (code law) system in Germany, Japan and France and an outsider (common law) system in the UK, US and Canada (La Porta, Lopez-de-Silanes et al. 1998; Hall and Soskice 2001).

This distinction refers to the typical patterns of coordination within national business systems. Accordingly, the countries traditionally displayed diverging goals, functions and institutional designs for financial reporting. While in the UK, US and Canada, regulation has a longstanding tradition of self-regulation by the accounting profession; Germany, France and Japan rely on a more legalistic approach. In fact, the national configurations represent different paths of accountancy regulations with diverse formative institutional developments. Thus, finding convergence in these traditionally different regimes points to a possible global harmonisation of the regulatory landscape.

This article contributes to the literature in the following ways. First, it contributes to the literature addressing changes in and convergence of financial reporting systems (Gornik-Tomaszewski and McCarthy 2003; Ruder, Canfield et al. 2005; Tarca 2005). Previous studies were often restricted to single country analyses and, thus, unable to identify convergence between regulatory regimes (Fearnley and Sunder 2006). Second, we suggest that accounting regulation is getting more similar across countries – even though the paths of change might differ. Third, this article contributes to the literature that considers the convergence of national business, corporate governance and financial reporting systems (Knill 2005; Khanna, Kogan et al. 2006), as our findings could be interpreted as resulting from these systems growing more similar. Forth, this article contributes to the literature on governance – or modes of regulation – in accounting (Streeck and Schmitter 1985; Puxty, Willmott et al. 1987) by proposing a new framework for analyzing regulatory changes, which considers both accounts changes in the public-private and the national-international mix.

The remainder of the article is organised as follows: Chapter 2 provides the theoretical framework for the description of accounting regulation and changes in regulation over time. Additionally, we show how private actors may take on responsibility in the field of regulation and how legal actors back regulation. Aims and objectives as well as the rationale for internationalisation are also covered in chapter 2. In chapter 3, we describe origins and changes of the accounting system for three European country cases: Germany, France and the United Kingdom. In chapter 4, three non-European country cases are addressed: The United States, Canada and Japan. Finally, chapter 5 summarises our findings.

2 FRAMEWORK FOR ANALYSIS

Over time, two changes can occur within a country’s regulatory setup. First, there might be variation in the public-private mix and second, there also might be variation in the national-international mix as public and private actors can both be national or international “players” (Porter 2005). Over time, such changes can lead to a cross-country convergence in regulatory patterns. We use a four-dimensional framework based on existing studies, which analyse shifts in accounting regulation over time (Haller 2003; Meek 2003) and identify whether or not there is convergence of accounting regulation across countries (Ruder, Canfield et al. 2005; Nobes and Parker 2006; Choi and Meek 2008). To analyse different regulatory solutions and to assess changes over time, accounting regulation within a country is captured with four criteria: (1) the predominant uses of accounting, (2) the extent of professional self-regulation, (3) the legal backing of financial reporting, and (4) the degree of internationalisation. We briefly describe each of the criteria below.

Predominant uses of accounting: This criterion refers to the function that accounting primarily assumes in a country. We distinguish between the information function of accounting to provide useful information for decisions of capital market participants (Demski and Christensen 2003) and its usage to determine distributable income and payable taxes (Leuz, Deller et al. 1998; Watrin 2001). The literature shows that fulfilling one purpose prevents accounting from being able to fulfil the other to the same degree (Zhao and Millet-Reyes 2007). In some countries – such as Germany and Japan – one of the predominant uses of accounting has been the calculation of distributable income and taxes payable (Haller 1992; Eberhartinger 1999), while in others – such as the United Kingdom or the United States – accounting's main function was seen as giving capital market participants a true and fair view of a company's economic situation (Walton 1993). This criterion is informative about the roles financial accounting fulfils within a country, and therefore considers influences of tax rules and interferences of further legal restraints (Haller 1992). This could be important to identify barriers to harmonisation.

Legal backing: The legal backing refers to the degree to which the public sector intervenes in accounting regulation. For instance, parliaments (setting accounting related laws), state agencies (overseeing the accounting process) and courts (setting accounting related case law) might lead to a strong legal backing of accounting regulation. For example, accounting rules are, to a large extent, codified in law in France, while concrete accounting rules are unlikely to be found in United States federal law (Colasse and Standish 2001). Legal backing can, however, also be achieved by strong agencies like the United States' Securities and Exchange Commission (SEC) (Black 2001). It can also be furthered through a strong role of courts in setting "accounting case law", as was observable in Germany but not in the UK (McBarnet and Whelan 1991).

Extent of professional self-regulation: In many countries, accounting was predominantly seen as a technical issue, at best self-regulated by those directly concerned with preparing or testifying accounts. However, there is particular concern over whether or not allowing self-regulation to be the only form of regulation is really in the public interest, as accounting also serves a social function. If this question is negatively answered within a society, there will be some amount of state intervention into accounting regulation, and some amount of legal backing will be introduced for interventionist reasons (see previous criterion) (Sikka and Willmott 1995). However, private actors typically will retain some role in accounting regulation (which might, however, vary over time (Olivier 2001)). The extent of professional self-regulation should, thus, be regarded as a distinguishing criterion when analyzing accounting regulation. This criterion, together with legal backing, is informative about the public-private mix in accounting regulation (Puxty, Willmott et al. 1987).

Public sector actors are typically parliaments (setting the respective law), state agencies, courts (which are important for the evolvement of litigation risk to appear) and – in some countries, such as Germany – bodies under public law. Private actors who play a role in accounting regulation are first and foremost mandated or un-mandated private institutions and experts. While law specifies many of these institutions, they do not belong to the state sector, as only private actors are involved. Typically, existing accounting regulation within a country is characterised by involving different combinations of public and private actors. This setting can be described by the notion of “governance”, meaning that networks exist that combine both public and private actors (Benz 2004). In such networks “private actors may have independently engaged in self-regulation, or a regulatory task may have been delegated to them by a public authority, or they may be regulating jointly with a public actor” (Héritier 2002).

Degree of internationalisation: While accounting was traditionally regulated at the national level, in the last decades international elements of regulation have also entered the stage. Some of these regulatory elements are rooted in the private sector, others in the public sector. Most remarkably, privately organised international standard setters, such as the International Accounting Standards Board (IASB), have gained increasing relevance (Kleekämper and Kuhlewind 1997). The European Union, obviously belonging to the public sector, is also increasingly engaged in regulating financial reporting for its Member States (Brackney and Witmer 2005). This last criterion, finally, sheds light on the degree of internationalisation. With standard-setting leaving the national arena, the public sector’s task of intervening into accounting regulation may also be internationalised (Decker 2002; Benner, Reinicke et al. 2004).

3 EUROPEAN COUNTRY CASES

Developments in accounting regulation of European countries are largely influenced by European legislation. Accounting related company law was harmonised via binding EC Directives, which led to a certain degree of formal convergence in the countries of the EU. The Europe wide application of International Financial Reporting Standards (IFRS) for consolidated accounts has led to a strong convergence of accounting practices. However, we observe a continuing lack of factual convergence in-group accounting, stemming from national cultures of using the alternative allowed treatments in current IFRS. Moreover, the mandatory turn to IFRS in the EU so far has been restricted to consolidated accounts of listed firms in its member states. Accordingly, a variety of national standards remain relevant for all other types of company accounts. The consequences of this particular approach to harmonisation will become apparent when we look at the country cases of Germany, France and the UK.

3.1 Germany: Strengthening the role of information accounting

The predominant use of accounting

One special feature of German accounting is its strong interconnection with taxation. The German legislator decided in the 1920s that financial reports would be the basis for determining taxable income. With this, tax accounts were intended to follow the rules of financial accounting (*Maßgeblichkeitsprinzip*). This connection between accounting and tax rules in fact worked in both directions and led to the reverse authoritative principle (*umgekehrtes Maßgeblichkeitsprinzip*), which states that tax legislation could also affect financial reporting rules. Thus, tax legislation became a relevant source of accounting rules in Germany until the reverse authoritative principle was abolished in 2008. While it would have, in theory, been possible to develop separate accounting rules for group reporting to remedy tax laws’ adverse effects on financial reporting, this did not happen, as accounting rules for company and group accounts in the German Commercial Code (*Handelsgesetzbuch,* HGB) remained fairly similar for a long time. One possible explanation for these similarities in regulation may be found in the German insider business system, where accounting information was of low relevance for the decision-making process (Busse von Colbe 1996; Ali and Hwang 2000). Consolidated accounts were dispensable in this system; they were only introduced in Germany as a mandatory element of financial reporting in 1965 and they remained relatively unimportant until the 1990s (Nobes and Parker 1991), when the German financial system changed due to the increasing importance of capital markets. Large, listed companies began to express their concerns that German accounting rules were not informative for investors and, hence hindered the company’s efforts to raise capital abroad (Thiele and Tschesche 1997; Schildbach 2002). In 1998, the Capital Raising Facilitation Act (*Kapitalaufnahmeerleichterungsgesetz*, KapAEG) was adopted and brought significant changes. Listed (parent) companies were now allowed to publish their consolidated financial statements following accepted international accounting standards, which were in practice either IFRS or US GAAP. The act was designed to enhance German firms’ abilities to access foreign capital markets (especially in the US) because the widely used reconciliation statements had been proven costly for preparers and puzzling for users. As US GAAP statements of US firms were accepted for listing on Germany’s stock exchanges already, the legislator saw its act as abolishing the discrimination towards domestic companies. Moreover, the act was intended to strengthen the German capital market by introducing investor-oriented financial reports. Retrospectively, the intention to foster cross listings of German firms turned out to be less important, as only a small number of firms found these new rules attractive enough to list in the US. The second reason of strengthening information accounting in fact was more relevant. A large number of companies have used the opportunity that they had lobbied for (Born 2002) and applied IFRS or US GAAP after the KapAEG had been passed.

With the EU’s turn to IFRS in 2005, investor oriented financial statements became mandatory for all listed firms in Germany on the group account level, while the requirements for single accounts remained unchanged. However, in line with worldwide tendencies towards more information oriented financial reporting, German GAAP has been changed significantly since then. The Accounting Law Modernisation Act (*Bilanzrechtsmodernisierungsgesetz,* BilMoG) of 2009 has, in particular, aligned German accounting laws with international practices. The law intends to establish a cost efficient alternative to IFRS for small and medium sized companies without giving up the traditional function of calculating the distributable income (Hoffmann 2009), Zimmermann 2009).

The legal backing of financial reporting

Accounting regulation in Germany is commonly associated with a high degree of state intervention. Parliamentary rule setting has a long-standing tradition: The relevant law on accounting was proposed by the respective ministries (bureaucracy) and then had to be approved by the parliament. Public sector accounting rules date back to the first simple prescriptions included in codified law in the 18th century (Born 2002). Mandatory disclosure of a balance sheet and a profit and loss account were first introduced in 1884. Subsequently, numerous disclosure requirements were included: Mainly into the commercial code, but also into corporation law. First introduced in 1897, the HGB supposedly constitutes the primary source of accounting regulation; however, this law did not contain many detailed rules on financial reporting until EU regulation was transposed into German law, amending the HGB.[1]

German General Accepted Accounting Rules (*Grundsätze ordnungsgemäßer Buchführung*, GoB) in fact consist of various inputs: regular practice, academic inputs, jurisprudence and professional opinions. Here, jurisprudence is of outstanding

1 Today’s accounting rules in the HGB are mainly an outcome of the adoption of European directives.

importance, as court decisions represent final decisions on what is acceptable as GoB. In particular, tax legislation and the courts had a high degree of influence on accounting practice. The importance of courts in advancing German accounting rules can, therefore, partly be explained by the interconnection of financial reporting with taxation. The high practical relevance of taxation implied that the relevant count rulings were often considered the major source of accounting rules (Born 2002). Even though the scope of the national parliament on setting accounting rules was diminished through European legislation, formulating accounting rules for single accounts remains a duty of the public sector and not of any private actors.

The extent of professional self-regulation

German accounting traditionally relied less on the forces of professional self-organisation that shaped accountancy in many other national systems. The predominant absence of the profession in disclosure regulation was partly due to its size, and partly due to strong legal regulation. In Germany, the accounting profession, with only auditors qualifying for membership was understood in a much narrower sense. The first professional body of auditors was founded in Berlin in 1900. The first national institute, the Institute of Auditors (*Institut der Wirtschaftsprüfer*, IDW) was established in 1930. Unlike their British counterparts, membership was not obligatory and carried neither weight or responsibility. This changed in 1934, when all auditors were required become members in order to practice – an arrangement corresponding to other ‘purification’ attempts of the time. After a short wartime interlude of a body under public law, the IDW resumed its role as an oversight body. In 1961, the Public Accountant Act (*Gesetz über seine Berufsordnung der Wirtschaftsprüfer*, WPO) stipulated the creation of a Chamber of Public Accountants (*Wirtschaftsprüferkammer*, WPK), to which an auditor had to belong in order to practice. The WPK, an organisation under public law, was now responsible for oversight, admission, quality control, and the development of auditing standards. The IDW returned to its original role: being an organisation for lobbying on behalf of accountants and for giving advice.

Further, while no official standards setter existed, the IDW pronounced standards for auditing, which guided balance sheet preparers and were relevant in court decisions (Schruff 2006). In this indirect manner, the IDW exerted influence on the genesis of the GoB (Marten, Quick et al. 2003). A landmark change happened in 1998 with an omnibus bill named the Corporate Sector Supervision and Transparency Act (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*, KonTraG). It contained an amendment to the commercial law that authorised the Federal Ministry of Justice to accredit a private standard-setting institution, which resulted in the creation of the German Accounting Standards Committee (GASC) in the same year. The GASC is an incorporated association under private law, membership to which is open to companies and the interested public. Its steering committee (*Vorstand*), elected by the general assembly, appoints the German Accounting Standards Board (GASB), which consists mainly of users and preparers of financial reports. The GASB was authorised to (1) develop recommendations for group accounting, (2) advise the Ministry of Justice in accounting legislation proposals and (3) represent Germany in international standardisation bodies. In its contract with GASC, the Ministry of Justice committed itself to involve the GASB in all legislative proposals concerned with accounting. The major task of the GASB, however, was to independently develop accounting standards for consolidated financial statements. So far, the GASB has pronounced 17 German Financial Reporting Standards (*Deutsche Rechnungslegungsstandards,* DRS), while its Accounting Interpretations Committee (*Rechnungslegungs Interpretations Committee*, RIC) has issued five documents interpreting these standards.

The GASB was set up as a last-ditch effort to retain some state control over group accounting when large international firms started turning to international or US accounting standards. GASB membership is fully determined by the private sector, but the GASB standards must be approved by the state. The IAS-regulation on the European level rendered this attempt meaningless. As with all national regulatory bodies in Europe, the GASB lost its competencies in setting accounting rules for listed groups and gave way for the EU-wide solution of uniform IFRS application. Today, the GASB focuses on developing group accounting standards for non-listed companies and on participating in the IASB’s deliberations.

The degree of internationalisation

A first wave of internationalisation of German financial reporting came through the transformation of EC regulations into German law, and, thus, amending the HGB. Germany enacted the Fourth (78/660/EEC) and Seventh (83/349/EEC) Council Directives simultaneously in 1985 by the Accounting Directives Act. This transposition caused a shift of many regulations either from GAAP or, more often, from specific company laws to the commercial code. The number of paragraphs in the commercial code concerning financial reporting skyrocketed, while the number of provisions in the corporate law was reduced. Although the immediate legislation applied to more firms, the accounting system remained largely unchanged due to the wide scope of choices within the accounting directives. When considering if the overall aims of the directives were met, the Commission was, however, satisfied with the adopted regulation and the ensuing practice. There was only one significant intervention, which occurred comparatively late: Germany was ordered by the European Court of Justice in 1998 to mend its transposition of disclosure requirements for public companies (C-191/95). In the Court’s opinion, Germany had failed to define appropriate sanctions for companies that proved reluctant to obey the respective disclosure obligations. The EC’s complaint resulted from the fact that less than ten percent of the affected companies complied with the disclosure obligations.

Internationalisation of accounting rules was further advanced by the issuance of the KonTraG. The decision not to require group accounts to be prepared mandatorily according to German GAAP, but to instead allow them to follow internationally set rules, was accompanied by strong objections from judiciary. Critics pointed to a potential lack of legitimacy for the externally set rules and to the impossibility of influencing future standards (Kirchhof 2000; Ebert 2002; Schildbach 2004; Bratton 2006). Accounting literature castigated the declining comparability among German group accounts – some being rendered according to German laws and German GAAP, others according to IFRS or US GAAP (Börsig and Coenenberg 1998). Thus, with the turn to IFRS in 2005, the second objection became meaningless while the first one still exist. Standards for group accounting strongly eluded from the influence of German authorities and became solely a matter of EU regulation.

Summary

German accounting rules emerged in close relation to tax legislation. Financial reports were primarily used to evaluate distributable income and to support company’s longevity, which acted to protect that company’s stakeholders, although the creditors were of primary concern among the stakeholders. Accounting regulation was traditionally dominated by state activities, as parliamentary rule setting seemed best suited to achieve the state’s stated goals. The relevant law on accounting was proposed by the respective ministries (bureaucracy) and was subsequently subjected to parliamentary approval. Lobbyists frequently intervened into parliamentary rule making, and the final law could be considered as a consensual solution (Ordelheide 1999). This distinguished the German approach to accounting practice, as it was never seen as overly influenced by a single interest group, such as the auditing profession. Interpretation of the law was the competency of courts. The legal backing of German accounting rules was, thus, traditionally high. As a result of this regulatory model, the information function of accounting was almost completely neglected. The overcome model changed with the increased use of capital markets as a source of finance, and with it the weight born by the accounting system. To strengthen the information function, separate group accounts were introduced to German law. The profession also became more involved in the standard-setting process. This development reached its climax during the period in which standards for group accounting totally eluded the influence of German authorities. This short phase was ended by the decision to require

IFRS for group accounts and the subsequent shifting of regulatory standard-setting to the EU. The path towards a strengthened role in information accounting in Germany's financial accounting system also is reflected in the recent BilMoG, which shifts German accounting rules more towards the Anglo-Saxon role model of true and fair view accounting. Table 3.1 summarises relevant accounting laws in Germany.

Table 3.1: Relevant accounting laws in Germany

1985, Accounting Directives Act *(Bilanzrichtliniengesetz,* **BiRiLiG**) Transformation of the Forth, Seventh and Eighth European Council Directive into German Law
1994, Securities Trading Act *(Wertpapierhandelsgesetz,* **WpHG**) Introducion of additional disclosure rules for listed companies
1998, Corporate Sector Supervision and Transparency Act (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich,* **KonTraG**) Amendment of the Commercial Law (HGB) to authorise the Federal Ministry of Justice to accredit the GASC
1998, Capital Raising Facilitation Act (*Kapitalaufnahmeerleichterungs-Gesetz,* **KapAEG**) Allowance for listed companies to publish consolidated financial statements according to IFRS or US-GAAP
2000, Financial Market Promotion Acts (*Finanzmarktförderungsgesetz,* **FFG**) Improving capital market transparency and foster legal framework for investors **2009, German Accounting Law Modernisation Act** (*Bilanzrechtsmodernisierungsgesetz,* **BilMoG**) Strengthen informational content of German GAAP financial statements, alignment with IFRS

3.2 France: Curtailing the nation state's dominance

The predominant use of accounting

Creditors and fiscal authorities were traditionally the main users of financial statements in France. In comparison to Germany, the requirement to publish consolidated accounts was introduced long after the duty to publish single accounts. Even though a company law reform introduced some regulation on group accounting in 1966, only 22 French companies published consolidated accounts in 1967 (Nobes and Parker 2006). Comprehensive regulation on group accounting was not introduced until the Seventh European Council Directive (83/349/EEC) was finally transposed to national law in 1985 through National Decree 85-11, although it was refined in 1986 with Decree 86-221 (Wooldridge 1988).

Major institutional changes in the French accounting regime and the resulting changes in the predominant use of accounting did not occur until the middle of the 1990s. After two waves of privatising public enterprises in 1986 and 1993 to increase the competiveness of French companies in increasingly global markets, several French companies started to raise capital through IPOs and intensified their usage of capital markets abroad (Rutz 1998). Hence, these companies were required to prepare consolidated accounts following internationally accepted accounting standards. Over time, it became apparent that the state-dominated French accounting standard-setting system was unable to adapt conceptually and operationally to international accounting requirements (Colasse and Standish 1998). This led to a major reform of accounting regulation. The French system now considers group accounts according to IFRS and single accounts under national GAAP.

The legal backing of financial reporting

Historically, the accounting standard-setting process in France was solely controlled by the state. Financial reporting standards were primarily formed by laws, leaving only small regulatory responsibilities to the professional accounting organisations and the courts (Barrett and Roy 1976). Dating back to 1673, France was one of the first countries in the world to establish a law forcing merchants to keep accounts (*Edict of Colbert*). In 1807, the first commercial code (*Code de Commerce*) was enacted as part of the *Code Napoleon,* and in 1867 the first general incorporation law came into force. The early state interventions made the French accountants in this time dominant concerning the number and quality of their publications (Most 1984). Nevertheless, the state only set general accounting guidelines during that period. The emergence of more detailed accounting rules began in the 1940s, when the so-called Vichy Government – under influence of the German occupation forces – developed an accounting code (Standish 1990). This code contained not only a general chart of accounts, but also requirements for the annual presentation of balance sheets and profit and loss accounts. Although the code was never applied the new government enhanced it and enacted the *Plan Comptable Général* (PCG) in 1947. Though it was relatively weak, the PCG additionally contained general accounting principles, valuation regulations and rules concerning the content and form of financial reports (Flower and Ebbers 2002). The PCG was enacted through a series of ministerial orders, which held little legal force. Moreover, the plan was initially only applicable to public companies in the commercial and industrial sector. Despite this legal weakness, time persuaded a relatively large number of private entities to voluntarily comply with the PCG. In 1957 the PCG was revised to introduce a more detailed chart of accounts, a manual of operating instructions, definitions of technical terms and recommendations for common accounting challenges. In 1965, the PCG also became the basis for tax accounting, which made the PCG requirements nearly universal (Scheid and Walton 1992). With the additional modifications in 1982, 1986 and 1999, the PCG has became one of the most important features in French accounting because it provides a more detailed interpretation of the basic principles held in general laws like the commercial code (Hoarau 2000).

In 1947 the French government also set up an accounting standard-setting body (*Conseil National de la Comptabilité,* CNC). [2] This agency belongs to the state sector, as it is financed by public money and is under the control of the Ministry of Finance. CNC members include individuals from various sectors: For example, government officials, accountants and representatives of industrial associations. While the inclusion of members from the private and non-governmental sector was supposed to support the CNC’s acceptance, the government in fact designates all members.

The CNCs main functions are to develop accounting principles, issue opinions (*avis*) on draft legislation and to maintain and enhance the PCG. Furthermore, the CNC played an important role in building up the doctrine by publishing opinions and recommendations and by coordinating accounting research. The doctrine could best be described as the prevalent opinion on accounting issues in science and literature (Hoarau 2000). The CNC, with its various stakeholders, had been obliged to achieve broad consensus in accounting questions. Nevertheless, and in contrast to other standard-setting bodies like the FASB, the CNC only advised the government. The standards proposed by the CNC were only recommendations (statement of best practice) until a ministerial order made them binding (Colasse and Standish 2001). The ministry therefore had the sole authority to change the PCG, which illustrates the strong position of the state in accounting regulation in the post World War period.[3]

Due to the state’s discontentment with the CNC’S structure, the CNC was reconstructed through decrees and ministerial orders in 1996. Membership was reduced from 103 to 58, whereby the private sector’s relative representation was strengthened. In addition, an Urgent Issues Committee (*Comité d’Urgence*, CU) was established. The CU was founded to give references to the appliance of specific accounting standards in respect to critical issues within three months; it also functions as standard interpretation committee (Hoarau 2000). Nevertheless, the legislator was still not fully satisfied with the organisational structure of the CNC. In a subsequent reform, the CNC only maintained its advisory function, while the standard-setting process was delegated to the

[2] From 1947 till 1957 the body was called *Conseil Supérieur de la Comptabilité*.

[3] A comparable legal constitution to the CNC was established with the banking act in 1984: The *Comité de la Réglementation Bancaire* (CRB), a state agency under the control of the Ministry of Finance. The CRB has the power to issue accounting rules for credit institutions.

newly established Accounting Regulation Committee, *Comité de la Réglementation Comptable* (CRC) in April 1998. Although the CRC is a public body, seven out of the 15 members come from the private sector. These are the presidents of the National Institute of Statutory Auditors *(Compagnie Nationale des Commissaires aux Comptes,* CNCC) and the Institute of Public Accountants (*Ordre des Experts Comptables,* OEC), three enterprise and two trade union representatives. However, the state still controls the CRC with a one-member majority and is represented by two ministers (Justice and Finance), two judges, a representative of the state audit office and the president of the CNC. The main task of the CRC is to adopt accounting standards following CNC recommendations (OEC/CNCC 1999). The CRC was established by the government to simplify the standard-setting process by creating a single body which is able to set mandatory standards for all bookkeeping entities, including banks and insurance companies (Hoarau 2000). With the creation of the CRC, regulatory authority is able to set accounting standards in a coordinated, fast and flexible manner. For the first time in France non-state representatives have been included in the process of accounting regulation (OEC/CNCC 1999).

The extent of professional self-regulation

Besides the state sector, two professional bodies have been engaged in developing accounting principles: The National Institute of Statutory Auditors, CNCC and the Institute of Public Accountants, OEC. Both institutions are incorporated under private law, but under the oversight of the Ministry of Justice and the Ministry of Finance, respectively. Although the OEC, an association of all certified accountants (*experts comptables*[4]), was already founded in 1942 it was not given the force of law by the interim government until 1945. To this day, the purpose of the OEC is to secure the independence and honour of the accounting profession, in addition to the publication of recommendations concerning audit procedures (Hoarau 1998). The CNCC was established by a decree in 1969. The membership of the CNCC consists entirely of certified statutory auditors (*commissaire aux comptes*). The main tasks of the CNCC are to develop and issue new auditing standards, to publish technical guidelines for their application and to overview statutory audits (OEC/CNCC 1999). However, the CNCC is also responsible for protecting the reputation and independence of its members. Both the CNCC and the OEC have members in the *Conseil National de la Comptabilité* (CNC), which was the governmental accounting standard-setting body set up in 1947, and, therefore, influenced the development of accounting standards. In 1998, the

[4] To become an *experts-comptables* accountants have to pass a special state examination and have to have at least three years of work experience.

government established the CRC as the new accounting standard setter, taking this role over from the CNC, which currently persists as a deliberation organisation. The OEC’s and CNCC’s presidents are both members of the CRC and the institutions, thus, still have some influence on accounting standard-setting.

The degree of internationalisation

As in the case of Germany, two main sources have been influencing the French accounting regime since the 1980s: economic and financial globalisation and the process of harmonisation within the EU. The harmonisation of accounting standards in Europe since the 1980s and particularly the implementation of the Fourth (Council Directive 78/660/EEC) and Seventh (Council Directive 83/349/EEC) EC-Directives brought several changes to the French accounting regime. The aim of the Fourth Directive was to harmonise annual reports of companies domiciled in the Community. It was passed in July 1978, but not implemented in France until 1983. The Accounting Act, implementing the Fourth Council Directive, contained regulations concerning form and content of the profit and loss account, the balance sheet and the annex of annual reports. Moreover, the basic principle to give a true and fair view was codified with the Act. A further Act in 1985, implementing the Seventh Council Directive, made the publication of consolidated accounts mandatory: In a first step, listed companies were obliged to publish consolidated accounts in 1986, since 1990, also unlisted groups have to provide consolidated accounts.

Before the 1980s, no compulsory rules for consolidated accounts existed. Some companies began publishing group accounts in the 1970s, often following US-GAAP due to the lack of established international standards (Touron 2005). In the 1990s, the importance of the French capital market increased and the use of foreign capital markets became financially rewarding for French entities. As a result, numerous companies complained about having to prepare multiple consolidated account statements. The government reacted to these complaints by passing a law in April 1998 that allowed all companies listed on foreign stock exchanges to prepare consolidated accounts on the basis of international accounting standards. However, the application of this law was subject to strict conditions, which were to be set by the CRC, like the translation of standards into French and the conformity of standards with European legislation. However, this decree was never published by the CRC and French companies were not allowed to prepare consolidated accounts on the basis of international accounting standards *instead of* national law until the translation of EU Regulation 1606/2002 in national law in 2005 (Delvaille, Ebbers et al. 2005). With this regulation, the EU adopted the application of IFRS on 19 July 2002 and, thus, since 2005 French companies have been required to prepare group accounts in accordance with IFRS.

Summary

Traditionally, the standard-setting process in France was dominated by the state or state controlled civil bodies. Particularly the legal status of the PCG, responsible for issuing detailed accounting standards, was rather ambiguous until the 1980s (Colasse and Standish 2001). However, the PCG together with the public actors and state controlled professional bodies formed a stable system of accounting standard setting. In this system, the CNC and two professional bodies, the CNCC and OEC, were also of particular importance. Since the 1980s, the French accounting regime has found itself in a tension between financial globalisation and the EU harmonisation process. Through the voluntary preparation of consolidated accounts on the basis of international accounting standards, international private standard setters like the IASC gained influence on the French accounting regime for the first time. However, the organisational structure of the standard-setting process did not change until 1998. With the establishment of the CRC a single body responsible for developing accounting standards and issuing financial reporting decrees was created and for the first time non-state representatives got involved in standard setting. Even if consolidated accounts had to be prepared under national GAAP until 2005, the CRC has aimed at converging French accounting standards with IFRS since its foundation (Delvaille, Ebbers et al. 2005). Nevertheless, companies in France were not allowed to prepare consolidated accounts on the basis of IFRS instead of local GAAP until EC Regulation 1606/2002 forced the French government to fully accept IFRS group accounts. Thus, the IASB has become an important actor in the standard-setting process since 2005. The governmental influence on standard-setting has been reduced to the area of individual accounts, further curtailing the nation state’s dominance.

3.3 UK: Boosting state influence

The predominant use of accounting

The predominant function of financial statements in the UK is to provide useful informational input for the decisions of financial market participants. The overriding principle is to provide skilled individuals, especially investors, with a true and fair view (fair presentation) (Walton 1993; Flower 2004). When the state began to regulate financial reporting in the beginning of the 20th century all corporations were required to prepare financial statements, with some exemptions for small businesses. The first consolidated statements in the UK[5] date back to 1910, but according to (Taylor 1996) consolidation was not really familiarised at that time. The Royal Mail (1931) case is seen as a turning point towards the increasing use of group accounts in the UK

5 These were the statements of the Pearson and Knowles Coal and Iron Co. Ltd.

(Edwards and Webb 1984; Bircher 1988). The London Stock Exchange was the first British organisation to require the preparation of group accounting statements for all listed companies in 1939 (Bircher 1988). The Companies Act of 1948 established a legal basis for group accounts, requiring all parent companies to publish group accounts in addition to their individual accounts. It was not until 1978 that consolidation became the required format for group accounts (Taylor 1996).

Although all financial statements are prepared for information purposes, single account statements are also used for the calculation of distributable income to pay dividends. Company law in the UK differentiates between accounting profit and the realised profit. The accounting profit is adjusted to determine the realised profit, which is then utilised as the basis for the distribution of dividends. Some authors (Nobes and Parker 2006) see taxation policy as marginally influencing financial reporting, while others negate this relation entirely (Lamb 1996; Eberhartinger 1999) due to their unique historical development in Britain. In comparison to other European countries, the influence of tax laws is negligible. Unlike in most EU member states, British companies gained the option to preparation of their single accounts according to IFRS in 2005. As a result, all accounting in the UK can be based on international rules and fully bypass national GAAP (Nobes and Parker 2006).

The extent of professional self-regulation

Professional self-regulation has a long-standing tradition in the United Kingdom. Between the 16th and the 19th century Britain was leading the evolution of accounting. British literature rightly claims the emergence of the ‘accounting profession’ as one of their nation’s contribution to accountancy (Flower 2004). The tradition of a strong, self-initiated professional self-regulation of numerous accounting and financial reporting issues has spread to many parts of the Commonwealth. The accounting societies and institutes shaped the British accounting system by admitting and educating the individuals who would influence the shape of the British system.

The state applied a *laissez-faire* approach and mostly relied on professional self-regulation until the beginning of the 20th century (Parker 1990).[6] In this arrangement, the accounting profession was primarily responsible for providing the rules for preparing financial reports: In the absence of legal stipulations, the professional bodies of the accounting profession issued guiding principles for their members to promote a ‘true and fair view’ in their professional judgement. These could vary between different

[6] As Parker, R. H. (1990). "Regulating British corporate financial reporting in the late nineteenth century." Accounting Business and Financial History **1**(1): 51-71. points out, some firms of high economic importance (such as railroad companies) were actually regulated rather intensively.

professional bodies (Walton 1993). As a result of the markets free operations, accounting practice varied considerably over time and between industries (Lee 1984).

An accounting fraud in the 1930s[7] marked the turning point for disclosure regulation in the UK and led to the agreement that accounting practices should be regulated more strictly. There were two divergent positions in the profession about the implementation of the new rules: One group thought that accounting and auditing could be improved by more detailed legislative prescriptions, while another opined that the accountancy profession should seek to achieve such improvements, with possible subsequent statutory support from parliament (Lee 1984). Eventually, the tradition of minimal governmental intervention prevailed and the second route was taken.

In the 1970s, the impending EC-membership made the diversity of accounting rules within the UK to seem arcane and inappropriate. Hence, the professional bodies began to harmonise the rules among the various institutes and societies. Therefore the largest of the professional bodies issued the ‘Statement of Intent on Accounting Standards’ in the 1970s. As a result, three major professional bodies – with numerous others joining later in the decade – sponsored the creation of the Accounting Standards Steering Committee, which was soon renamed the Accounting Standards Committee (ASC) (Defliese 1981). The group of professional bodies involved in the creation of the ACS became known as the Consultative Committee of Accountancy Bodies (CCAB) (Pong and Whittington 1996). The accountancy bodies jointly governed the ASC and each retained veto power over any standard. This structure resulted in the ASC having little authority to make decisions without satisfying its members’ wishes.

Despite its relative weakness, the ACS represented a first step in the slow journey towards a single set of standards, and the eventually genesis of UK GAAP. Very often, the final standards were based on compromises (Choi and Meek 2008). After some time of this movement towards a unified GAAP, the competitive societal mechanism that had relied upon a variety of professional bodies began to collapse, and was further diminished when the national legislator translated European regulations into national law (Lamb and Whittington 2001). Although the UK retained the private arrangements wherever possible, this process resulted in a substantially increased role for the state.

The main organisation responsible for regulation and supervision is a not-for-profit that is financed by the state, the accounting profession and the companies to which its standards apply. It operates under the name of the Financial Reporting Council (FRC), as a limited liability company with a state guarantee. Its directors are drawn from the business world, but appointed by the state. There are numerous bodies staffed by the FRC that are worthy of mention. Likely the FRC’s best-known subsidiary, the Accounting Standards Board (ASB) promulgates the pertinent accounting standards.

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[7] The case of the Royal Mail Steam Packet Company in 1931.

The Financial Reporting Review Panel (FRRP) inquires into potential violations of accounting rules, while the Professional Oversight Board (POB) regulates auditing. The Accounting Practices Board (APB) pronounces rules on auditing and the Accountancy Investigation & Disciplinary Board (AIDB) conducts active oversight to ensure those rules are being followed.

As a consequence of these reforms, the role of the respective professional bodies has been significantly reduced. In acknowledging that there is a wide array of interests in financial reporting, the ASB now also draws its membership from the corporate and investment world. The other bodies ensure that violations of disclosure and enforcement rules are quickly and transparently dealt with, which also means that the disciplinary proceedings of the professions have partly lost their importance. The increased supervisory role bundled in the FRC can also be seen as a consequence of the centralised structure of accounting regulation, which has made competition between the professions impossible. Overall, the state has taken on only a coordinating role: A closer look into the membership of the Council bodies reveals some distance to the state and political decision-making. Members are still drawn from the major representatives of the corporate world at large and not from the government executive or politics.

The legal backing of financial reporting

The first notable involvement of the state in British accounting regulation occurred in 1907, when company law introduced mandatory disclosures of audited balance sheets. Before 1907, disclosure was minimal, legal rules for recognition and measurement did not exist, and auditing was only utilised as an enforcement mechanism for a small number of companies. Generally, “...the company was seen as a private arrangement involving shareholders and directors, and secrecy in business matters was regarded as a virtue” (Roberts, Weetman et al. 2005). This minimal state interference was augmented when the important Companies Act 1948 outlined more specific rules on disclosure, specifically that, profit and loss accounts were to be disclosed and consolidated accounts must to be published. The Act demanded from firms to give a true and fair view (fair presentation) according to the demands of skilled addressees, especially investors (Walton 1993; Flower 2004). It also introduced some basic, concrete accounting rules, such as the distinction between reserves and provisions, which was enacted in order to make the creation of hidden reserves more difficult (Nobes and Parker 2006). Yet, laws remained rather unimportant, and the judiciary also traditionally avoided interfering with questions of recognition and measurement (Flower 2004).

This period of *laissez-faire* lasted until the British accession to the European Economic Community. The first change occurred with the transformation of the Fourth Council Directive (78/660/EEC) into national law with the Companies Act of 1981. The

Companies Act of 1989 gave a legal prescription for accounting standards for the first time. The passing of the new Companies Act coincided by no means incidentally with several initiatives by the Consultative Committee of Accounting Bodies (CCAB). When the EC regulations for company accounts were implemented in 1981, the overall structure of standard-setting remained the same. However, in the years that followed, it became clear that the rather loose type of cooperation in standard-setting warranted improvement. The Seventh Council Directive (83/349/EEC) thus proved to be a catalyst for a major overhaul in standard-setting (Whittington 1989). In November 1987, the Dearing Committee was appointed by the CCAB to put forward changes for the standard-setting process (Eccles and Holt 2005). Following the recommendations contained in the Dearing Report, the ASB was established in 1990 as operating body of the FRC and functionally replaced the Accounting Standards Committee (ASC). Although privately organised, the FRC possesses a strong legal backing, as it is partly funded and staffed by the Department of Trade and Industry (DIT).

The degree of internationalisation

Europe did not have a great impact on the regulation of the accounting in the UK until the early 1980s. The first major influence was the transformation of the Fourth Council Directive (78/660/EEC) into national law (Companies Act of 1981). The corresponding Seventh Council Directive (83/349/EEC), however, only became law with the Companies Act of 1989. This made the UK a forerunner with regards to company accounts, but not in regard to consolidating the accounts of groups. With the transposition of the Fourth Directive (78/660/EEC) into British law, the number of detailed legal prescriptions multiplied. As a result, both standard-setters and preparers of financial reports found their discretion significantly constrained. The European regulation provided detailed specifications about which accounting treatments were applicable and how a financial report was to be structured. Contrasting the previous national practice with the new European approach, the European approach constituted a major legislative interference and reflected the procedural notion of accounting regulations that most other member states shared. In addition to pressure arising from European harmonisation, the political rational to further develop London as the major financial centre in Europe strongly influenced the internationalisation of accounting regulation in the UK. Allowing international disclosures on the London Stock Exchange (LSE) widened the market for foreign listings. The strong involvement of the UK in the creation and operation of the IASB, whose headquarters are located in London, also resulted from this motive to embrace internationalisation.

Summary

The British financial reporting system has undergone substantial changes. Starting off with very little state intervention in the form of rudimentary legal stipulations and vast self-regulation, the public sector has increased its influence over time. Especially in the field of disclosure regulation, changes were largely triggered by EU harmonisation efforts, which led to more detailed stipulations in the British Companies Acts. Today's system relies on a number of bodies under private law and a quasi-governmental agency in securities regulation. In contrast to the traditional self-regulation approach, currently all of these institutions are officially acknowledged and, at least, indirectly monitored by the government.

4 NON-EUROPEAN COUNTRY CASES

In chapter four, we consider country cases outside the EU to test whether convergence in accounting regulation truly represents an international phenomenon, or if it is restricted to the EU. In the European country cases, we described common patterns of change: In the last decades, the information function of financial reporting, at least for consolidated accounts, became a predominant aspect even in countries where payout calculation has traditionally dominated financial accounting. The balance between state- and self-regulation also converges as traditionally liberal governed countries (e.g., UK) show stronger involvement of the state as an actor in accounting regulation, while traditionally state governed countries (e.g., Germany) embrace more private involvement. Overall, the tendency to replace national by international solutions can be observed in all European country cases. A strong driver for these harmonisation processes can be found in the globalisation of international markets (Griffin 2004). Globalisation has two major effects on regulation. First, it increases competition among national economies and second, it harmonises market conditions internationally (Levitt 1983). In response to these changes a gradual convergence of formerly distinct regulatory solutions in Europe occurred. In order to explore the possible alternative explanation for these developments, the changes in accounting regulation in the United States, Canada and Japan are discussed in the following sections.

4.1 US: Adjusting the public-private mix

The predominant use of accounting

In the United States only one set of financial accounts exists which is strictly designed for information purposes. The calculation of amounts distributable to shareholders maybe linked to accounting figures prepared in accordance with GAAP, but in general this is not the case and left to private arrangements with creditors. Moreover financial statements are not used for the calculation of taxable income. Accounting rules and fiscal rules are strictly independent as tax reports are generated outside of the accounting framework (Lamb, Nobes et al. 1998). An outstanding feature of the US accounting system is that only companies listed on stock exchanges and registered with the SEC are required to prepare financial statements according to US GAAP.[8] The Securities Act (1933) and the Securities Exchange Act (1934) assigned the SEC with the competency to set the financial reporting standards for this purposes (Puxty, Willmott et al. 1987). In this capital market oriented setting, informing investors constitutes the primary accounting function. The economic entity, other than the legal entity, is the focus corresponding to the informational needs of capital market participants. Consolidated accounts therefore completely substituted companies’ parent-only statements in US-GAAP. Deviating from the UK’s practice, consolidated accounts in the US are thus not additional to parent only accounts but represent full substitutions.

The legal backing of financial reporting

The origins of universal financial reporting rules for listed firms can be found in the securities legislation following the stock market crash of 1929 (Morgan and Previts 1984): Accounting regulation was ushered in with the Securities Act of 1933 and the Securities Exchange Act of 1934 (primary acts) when the federal government decided to intervene substantially into financial reporting, most visibly with the creation of the Securities and Exchange Commission (SEC). The legislation puts ultimate responsibility for the development of accounting standards for publicly traded (listed) companies with the SEC. The road to accounting intervention taken by the US government was different to most other countries, as it did not regulate accounting via company law. In the US, company law is not a federal responsibility, and so only securities law allowed intervention into corporate disclosures.

Since its foundation, the SEC is visible mainly in respect to its registration and filing procedures as well as its enforcement activities. In 1973, the SEC issued its Accounting Series Release No. 150, in which the commission recognised the FASB’s pronouncements explicitly as determining GAAP. This established the FASB as the primary agent exercising substantial authority over the determination of financial reporting standards (Morgan and Previts 1984). Practically, the role of the SEC now rests on its veto powers and the participation in the FASB’s deliberations (Newman 1981). The SEC primarily participates through comments on drafts of regulations, and always made clear that it would step in and set standards itself if the private-sector standard-setter failed to meet the regulator’s expectations (Hendriksen 1977).

[8] Reporting duties of all other companies are not regulated on the federal level and thus subject to State regulations.

A shock for the globally well-appreciated system occurred with the series of accounting frauds in 2001 and 2002 that are associated with names like Enron or WorldCom. With the Sarbanes-Oxley Act of 2002, the legislator reacted on what was broadly perceived as a crisis of the world’s most advanced financial reporting system. The act mainly contains a further strengthening of internal controls, enforcement, and puts forward harsher penalties for responsible managers. It is commonly understood as the most severe regulatory intervention since the securities regulation in the 1930s when the SEC was set up (Thompson and Lange 2003). New regulations introduced with the Sarbanes-Oxley Act (SOA) of 2002 had implications for the oversight of auditors, the organisation and the funding of the FASB as well as for accounting standards applicable to listed firms under SEC-supervision.

The extent of professional self-regulation

In the field of professional self-regulation, financial reporting in the US was initially very close to the British accounting system. After its final emancipation from these roots in the 1930s, most of the literature sees US GAAP as the dominant power for the modern developments in accounting. Before the legal recognition and foundation of the SEC, accounting was merely an issue of voluntary disclosures or stipulation by the stock exchanges, comparable to the UK’s *laissez-faire* approach. Although the SEC is strongly legal backed, standard-setting was traditionally delegated to bodies under private law. Hence, the private sector has played a major role in standard-setting from the beginnings of the new model (Sanders 1936). Hence, US GAAP have been influenced substantially by the pronouncements of private bodies.

Three episodes of private standard-setting can be observed in the US, involving different institutional structures of private standard-setters (Heintges 2005). Those episodes are associated with the following bodies: (1) the American Institute of Certified Public Accountants’ (AICPA)[9] Committee on Accounting Procedure (CAP; 1936-59); (2) its successor, the Accounting Principles Board (APB), which was also run under the Institute’s umbrella (1959-73) and (3) the existing, independent Financial Accounting Standards Board (FASB), which ended the AICPA’s standard-setting responsibility in 1973.

Both efforts to formulate accounting standards under the responsibility of the AICPA crashed because of their complicated standard-setting processes and their lack of independence from the profession (Roberts, Weetman et al. 2005) and of legitimacy, as both standard-setters where never formally acknowledged by the SEC. In 1971, after the

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[9] The AICPA was founded in 1887 as the American Association of Public Accountants, reorganised in 1916 and was renamed as American Institute of Accountants in 1917. The present name was adopted in 1957.

failure of the APB, the academic American Accounting Association (AAA)[10] proposed appointing an interdisciplinary commission to consider how accounting standards should be developed in the future. The AICPA reacted by appointing a study group, known as the Wheat Commission. Its recommendations included the creation of a Financial Accounting Standards Board (FASB) separated from the accounting profession. The almost immediate adoption of the Wheat Committee's recommendations resulted in the creation of the third US standard-setting body, the FASB that is still active today.

The success of the FASB's endeavours has two sources, one being procedural and the other organisational. The Wheat Committee had recommended the setup of a practice-oriented standard-setter. Theoretical development of accounting was seen as a task of the AICPA and the AAA (Larson and Holstrum 1973; Zeff 1999). The Board, however, did not want to outsource the foundational parts of standard-setting and decided to work on its own conceptual framework, a collection of broad principles that is supposed to enhance consistency among the binding pronouncements (Zeff 1999). This procedural decision is often considered as the reason of the FASB's success as well as its distance to the accounting profession and its professionalism.

The degree of internationalisation

US accounting standards have been adopted from many other countries but the US regulator's perspective remained solely on the development of accounting standards relevant for the national financial system. With the foundation of the IASC in 1973, a private and supranational institute comparable to the FASB emerged. The IASC intended to develop international financial reporting standards and gained importance by the EU's decision to require group accounts on the basis of IFRS. The FASB and the International Accounting Standards Board (IASB) announced the issuance of a memorandum of understanding ("Norwalk Agreement") in October 2002 intending to formalise their commitment to the convergence of US and international accounting standards. In 2007, the SEC decided that foreign companies registered at US stock markets and classified as foreign private issues are no longer required to prepare a reconciliation of IRFS accountings to US-GAAP (SEC Release NOS. 33-8879 of 21.12.2007). Further changes to group accounting in the USA could result by roadmap proposed by the SEC in 2008 for the adoption of IFRS for US issuers beginning in 2014. Still, compared to most other OECD countries the United States represent one

[10] The American Accounting Association was established in 1916 as the American Association of University Instructors in Accounting. The name was changed to the American Accounting Association in 1935.

rare example, where the financial reporting system has not been influenced by international developments until very recent.

Summary

Accounting regulation in the United States is built on a unique mixture of a state engagement and private sector activity. Originating from the British tradition of self-regulation, professional bodies were traditionally strong and played a decisive role in the development of the US accounting landscape. Different to the British model, the state intervened rather early in the accounting regulation for listed groups. Here, securities laws and the SEC guaranty a strong influence of the federal state. The FASB as the most important standard-setter belongs to the private sector: Organisationally independent, it balances interests receiving inputs from the profession (i.e. AICPA) and other lobbying groups. Other than in some European states, tax regulation has no effect on accounting regulation in the US and the use of single accounts is left to private arrangements beyond the regulatory scope of the state. Internationalisation has not been an issue in the US for a long time, as US GAAP were often referred to as ‘international accounting rules` and broadly adopted by foreign states. With the increased relevance of IFRS, the United States is stronger engaging in international cooperation in the field of accounting regulation. The history of accounting regulation in the US is characterised by adjusting the public-private mix, with the rise of a strong international standard setter a probable future task will be the adjusting of the national and international competencies.

4.2 Canada: Strengthening local markets with international accounting

The predominant use of accounting

Canada stands in the Anglo-Saxon accounting tradition, where generating decision useful information for external users is the main purpose of financial statements. This is partly due to the same legal tradition but also due to large economical interconnections with the United States (Nobes and Parker 2006). In Canada the calculation of distributable income and taxes is separated from financial reporting. Hence, taxation has no influence on accounting; insolvency and liquidity tests required by Canadian law for decisions on distributions do not build on accounting measurements. As the focus of Canadian accounting lies on providing decision useful information about the economic entity, Canadian GAAP does not address the financial situation of the legal entity. Single accounts therefore do not exist.

The extent of professional self-regulation

Typical for the Anglo-Saxon tradition, accounting in Canada was primarily seen as a matter of private actors who had to design financial reports according to commercial needs. The first development of Canadian accounting and standard-setting therefore was left to the hands of accounting professionals. Neither the state nor any other public sector organisation was traditionally involved in accounting regulation. Due to the fragmentation of Canada’s provinces, a number of regional independent accounting institutes emerged.[11] A great divergence of Canadian accounting regulation between provinces resulted. In 1910, the Dominion Association of Accountants (DACA) was enacted by the local institutes to facilitate cooperation and to set uniform standards of examination. The DACA undertook a first attempt to create a uniform standard-setting regime in the 1930s, with little success (Butterworth and Falk 1986). Two decades later, the DACA was renamed Canadian Institute of Chartered Accountants (CICA). Bulletins on accounting and auditing practices were issued by the Accounting and Auditing Research Committee (AARC) to provide guidance to CICA members. These bulletins represented the first step towards a common Canadian set of accounting rules, as they for the first time codified existing principles of accepted practice similar to common law (Baylin, MAacDonald et al. 1996). In the following years, the structure of the standard-setting process was altered when existing bulletins were reorganised into the CICA Handbook, which hence provided for the first consistent set of general accepted accounting principles (Stickler 1987). Although the CICA represents a professional body, its bulletins gained quasi-legal status in 1968. Since then, the CICA Handbook is recognised as codification of Canadian GAAP.

The legal backing of financial reporting

The first legislation dealing with the need for regulatory interference in financial reporting in Canada was the Dominion Insolvent Act of 1864. While the act did not provide for detailed accounting standards, it introduced the vital role of public accountants in Canada to act as ‘Official Assignees’ for the controlling of business in companies that were in bankruptcy (Thompson 1939). The first material intervention of law into accounting occurred in response to continuing financial crises in the second half of the 20th century, when concerns were spread about the adequacy of existing accounting and disclosure standards. By issuing the National Policy Instrument No. 27 in 1972, the provincial securities commissions required all public incorporated companies to report in accordance with the instructions outlined in the CICA Handbook. With this requirement these privately set standards became Canadian

[11] We will use the term provincial to include both provincial and territorial governments and legislation.

general accepted accounting standards. They were reinforced on the federal level with the Business Corporations Act of 1975. Criticisms on the structural and functional configuration summarised by several reports during the 1980s led to changes in the CICA. The Accounting Standards Board (AcSB) was founded in 1991 as private standard setter with close relationship to the CICA, ten years later composed under the umbrella of the Accounting Standards Oversight Council (AcSOC).

The degree of internationalisation

The Canadian accounting system evolved in close relationship to its neighbour in the United States due to the existence of several cooperative arrangements such as, the North American Security Administrators Association and the Multi Jurisdictional Disclosure System (MJDS). The latter came into force in 1991 and had a major influence on the common evolvement of both countries. The objective of the agreement was to make the access to US capital markets more efficient and less costly for Canadian companies and vice versa for US companies. Under the MJDS, foreign private companies are granted access to the national capital markets without additional registration and reporting requirements once they are registered with a securities authority in one country participating in the MJDS agreement (Houston and Jones 2002). The adoption of the MJDS was applauded by large Canadian issuers but has been used much less by US issuers to access Canadian markets.

Interestingly, the similarities and joint agreements with the US did not prevent the AcSB´s decision in 2006 to require limited companies to report in accordance with IFRS beginning in 2011. With this decision Canada is one of the first major OECD countries to completely replace national reporting standards with IFRS. The main reasons why Canada decided to adopt IFRS were the following. First, Canada’s capital market has less than a four per cent share of the global capital market (Cherry 2008). Therefore, Canada considers the adoption of IFRS as a cost-effective method to boost investments in Canadian capital markets (AcSB 2006). The second reason is that a continued strategy of harmonisation with US-GAAP would impose increased costs of compliance compared to IFRS on Canadian firms (AcSB 2006) and, in addition, Canadian GAAP is regarded as relatively more similar to IFRS which reduces the switching costs. Therefore, Canada adopts IFRS and not US-GAAP, although the US capital market has a huge significance for Canadian firms and several efforts were undertaken to minimise differences between Canadian accounting standards and US-GAAP. Moreover, many Canadian companies and investors disapproved copying the ‘rules-based’ of the US GAAP (Burrows 2006). And third, considerations of the SEC to remove reconciliation requirements of cross-listed companies preparing financial statements according to IFRS contributed to the Canadian decision. As this requirement is already dropped, Canadian companies listed in the US will not face any additional costs by mandatory switching to IFRS.

In order to prevent difficulties at the switching date, the adoption strategy is supported by a comprehensive implementation plan issued by the AcSB in 2006 (Hague 2007; Cherry 2008). The plan outlines key activities that should facilitate the adoption in 2011. Among other things the AcSB started to make IFRS conforming changes to the Canadian GAAP to diminish at least some difference between the two standard sets upfront. That the efforts are far advanced exemplifies the fact that the EU already recognises the Canadian GAAP as equivalent to IFRS as adopted by the EU (European Commission 2008). Aside from that, since 2008, the AcSB has begun to periodically issue the entire body IFRS and amendments as omnibus exposure drafts to incorporate them as benchmark to the existing standards and moreover to allow for early adoptions (AcSB 2008).

Summary

Canadian accounting regulation was traditionally characterised by professional self-regulation. The provincial accounting institutes were united on national level with the creation of the CICA, which gained standard-setting competency in 1972. Since then, Canadian companies are legally required to prepare financial statements in accordance with the CICA Handbook. The standard-setting process was reorganised a couple of times, but remained in the hands of the accounting profession. Neither the governments nor the securities commissions are involved directly in standard-setting, although they have the authority to intervene eventually (Robinson and Venieris 1996). Canada has been a founding member of the IASC and a vital participant in the creation of the IFRS. In 2006 it became the first major OECD country that will fully replace national GAAP with IFRS from 2011 on. This decision is indeed remarkable, as strong economic connections and former projects with the United States would favour harmonisation with US-GAAP. The decision reflects the increasingly important role of IFRS and the Canadian belief in the possibility to strengthen their capital markets with international accounting. Table 4.1 displays the major events in the evolvement of the Canadian standard-setting.

Table 4.1: Institutional evolvement of Canadian standard setting

Year	Institution	Acronym	Reform & Motive
1910	Dominion Association of Accountants	**DACA**	Foundation, to facilitate cooperation and to set uniform standards of examination
1933	DACA Terminology Committee		Foundation, attempt to create a uniform standard-setting regime
1946	Accounting and Auditing Research Committee	**AARC**	Created by AARC to provide guidance to DACA members

Year	Institution	Acronym	Reform & Motive
1951	Canadian Institute of Chartered Accountants	**CICA**	DACA renamed to Canadian Institute of Chartered Accountants
1972			All publicly incorporated companies are required to report in accordance with the CICA Handbook
1973	Accounting Research Committee	**ARC**	AARC was separated into these two Committees
1973	Auditing Standard Committee	**ASC**	
1982	Accounting Standards Committee	**AcSC**	Reform of the ARC
1988	Emerging Issues Committee		Established by CICA, to provide a forum independent of the AcSC
1991	AcSC replaced by AcSB	**AcSB**	Responsibility more focused on matters of principles and policy
2000	Accounting Standards Oversight Council	**AcSOC**	Established by CICA to oversee the activities and appoint the members of AcSB
2000	Public Sector Accounting Board	**PSAB**	Responsible for setting Accounting Standards in Public Sector
2006	AcSB		From 2011 on, Canadian GAAP will be fully replaced by IFRS

Source: Own illustration.

4.3. Japan: Bringing together different ascendancies

The predominant use of accounting

The principal objective of traditional Japanese financial reporting was measuring distributable and taxable income (Gordon 1999). The Japanese economy was traditionally characterised by large conglomerates around banks (also known as Keiretsu-systems) and thus can be classified as an insider-economy. Accounting regulation was organised accordingly with its major focus lying on prudentially calculating corporate payouts. For this purpose all corporations have to prepare financial statements in accordance with the Japanese Commercial Code (CC), which is also basis for taxation.

In addition to financial statements in accordance to the CC, publicly traded companies have to apply to the Securities and Exchange Law (SEL) which provides information to investors (Shiba and Shiba 1997). The introduction of this law in 1948 has to be seen in context with the US occupation and the attempt to introduce an outsider based financial system. According to the different sources of regulation Companies have to generate different financial statements: Single accounts traditionally required by the Commercial Code (CC) and consolidated statements required by the Securities and Exchange Law since 1977 (Radebaugh, Gray et al. 2006). Starting in the late 1990s the financial system has undergone severe changes, when the government started to deregulate and liberalise the financial sector with the aim to strengthen Japanese financial markets (Ito and Melvin 1999). The reforms initiated changes in the legal system trying to bring together the separated functions of creditor protection in the CC and the stronghold of shareholder interest in the SEL (JICPA 2006).

The legal backing of financial reporting

The main characteristic of the Japanese governance model during the last century has been a „triangular legal system“ comprising the Commercial Code, the Securities and Exchange Law and the tax legislation (Benston, Bromwich et al. 2006). Legal backing of accounting regulation in this setting was strong, as it was provided exclusively by the state in form of the Ministry of Justice (MOJ) and Ministry of Finance (MOF) via law. The Japanese Commercial Code, was enacted in 1899 and is based on the German Commercial Code (HGB) (Roberts, Weetman et al. 2005). Tax Law has a significant influence on financial reporting since it prescribes measurements of accounting figures to be shown in company’s financial statements prepared under the CC (Gordon 1999).

In 1949, the occupation forces introduced the Securities and Exchange Law. Both laws were transplants of US regulation and supposed to stipulate an information- and shareholder oriented accounting system similar to the US model (Benston, Bromwich et al. 2006). Significant changes occurred in the Japanese legal system during that period. The CC was modified and the Securities and Exchange Commission (SEC) founded with the aim to install a market based financial system after the US role model. An independent standard-setting organ, the Investing Committee on Business Accounting Systems (ICBAS), was created in 1948. This period of weakening the nation state in favour of more private solutions ended with the departure of the Allied Forces in 1952. The SEC, established as an independent agency to administer the SEL, was abolished and its duties were transferred to the Securities Bureau of the Ministry of Finance (MOF) (Cooke 1991). In the same way the ICBAS lost its independence and became a governmental unit under the oversight of the MOF. In 1952, it was renamed into Business Accounting Deliberation Council (BADC). However, the BADC issued a number of standards during the following years, but had lost influence after the shift from an independent body to an institution under state influence (Oguri and Hara 1990). Furthermore the revision of the CC reallocated elements on accounting regulation from the SEL into the Code and shifted the leading position in accounting from the SEL back to the CC.

Oguri and Hara (1990) mention two reasons for this process where the CC regains its role as primary source of accounting standards: The slow development of the securities market in the post war period and the vast influence of tax laws. The first favoured a bank based financial system, which in turn led to a strong demand for creditor oriented accounting rules as existent in the CC. The second was build on the fact that tax laws required financial statements to be prepared in accordance with the CC for the calculation of tax returns (Benston, Bromwich et al. 2006).

The recent Japanese reforms introduced a greater set of change in the accounting system, as they required substantial changes to the CC and the SEL. The commercial Code was amended in 2002 requiring consolidated accounts for large joint stock companies and introducing a fair value approach to the recognition and measurement of financial instruments (Benston, Bromwich et al. 2006). The New corporation law of Japan came into effect May 1st, 2006. This new law replaces parts of the Commercial Code and other related regulations (JICPA 2006). The legal basis for financial statement preparation now comprises of the SEL, the new Corporation Law and Tax laws.

The extent of professional self-regulation

The Japanese accounting regulation traditionally was almost solely based on state agencies and laws. A more self regulated system was introduced for the first time by the occupation forces (Oguri and Hara 1990). With the ICBAS they first created a standard-setting organ independent from any ministry. The ICBAS published ‘A Statement of Business Accounting Principles’ for the purpose of introducing general accepted accounting principles (Kikuya 2001). After the standard setter was reorganised as the BADC, the Principles no longer played a significant role in Japanese accounting practice. The Japanese Accounting profession was first organised under US occupation, when the Japanese Institute of Chartered Public Accountants (JICPA) was founded in 1948 (Nobes and Parker 2006). Although of little importance for the standard-setting process after the occupation ended, membership in the JICPA became compulsory for all CPAs in 1966. The JICPA releases statements and opinions on accounting issues and sets working rules for their members.

Beside the aforementioned agencies two other private associations were also important in Japanese standard setting: The Japanese Federation of Economic Organisations (Keidanren) (for details see Allinson 1987) and the Corporation Finance Research Institute (COFRI). Keidanren appointed members to the BADC in order to represent business interests in the council, while other lobbying bodies did not have such a significant influence (Cooke 1991). Besides this official lobbying, the organisation used its cosy relationships with the policy and bureaucracy to keep disclosure requirements on a minimum level (Oguri and Hara 1990). The COFRI, a private Organisation financed by donations from private corporations, undertakes research on financial accounting and reporting issues and published opinions and recommendations on accounting.

Professional self-regulation was strengthened with the recent reforms. As a part of it the Financial Accounting Standards Foundation (FASF) was founded in 2001 (Nobes and Parker 2006). Under its auspices, the Accounting Standards Board of Japan (ASBJ) was formed as a new private-sector standard setter striving to produce accounting standards of high quality similar to international standards like IFRS or US-GAAP (Misawa 2005). While the ASBJ’s role is the developing of accounting standards, the FASF has the responsibility for funding the standard-setting system from different companies and the accounting profession (Benston, Bromwich et al. 2006). The ASBJ started issuing new accounting standards in accordance with international standards, referring to the joint project with the IASB to meet convergence between Japanese and international accounting standards (JICPA 2006).

The degree of internationalisation

The Japanese accounting regulation has been influenced from different foreign jurisdictions and accounting philosophies. In a first phase the Japanese Commercial Code – implemented in 1899 – took the German Commercial Code (HGB) as a role model (Roberts, Weetman et al. 2005). During the occupation years the US forces introduced parts of their own regulation model, comprising of public and private regulation (Benston, Bromwich et al. 2006). These changes were abolished after the occupation forces had left and an inward looking national system was re-established. The JICPA was a founding member of the IASC but international standards did not play a role in the Japanese accounting system until 2005. A major change took place with the formation of the ASBJ in 2001. Since then new standards have been developed to harmonise Japanese accounting rules with international accounting standards to make Japanese security market more attractive to international investors. Continuing this process, in August 2007, the ASBJ and the IASB reached an agreement, known as the ‘Tokyo Agreement’, to accelerate the convergence between the Japanese GAAP and IFRS (ASBJ 2007). The two boards agreed to eliminate major differences between the two standard sets by 2008, with the remaining differences being removed on or before June 2011. Therewith, Japan engaged in a convergence activities for the first time, which had a specific scope and timing (Kaneko and Tarca 2008). Since then, the convergence process made a steady progress.

In the latest report on equivalence of the CESR, issued on April 22, 2008, the committee recommend the EU to consider Japanese GAAP as equivalent to IFRS by June 2008 (European Commission 2008). And in December 2008, the EU announced that Japanese GAAP besides other GAAPs is found equivalent to IFRS allowing Japanese companies to report in their national accounting standards while listing in the EU from January 2009 (European Commission 2008). In the future, Japan might proceed with its convergence activities by adopting IFRS as mandatory standard for listed companies by 2015 or 2016 (Business Accounting Council). However, it is already foreseeable that Japan similar to the EU would adopt a national ‘version’ of IFRS as carve-outs are already announced. An ultimate decision about the IFRS adoption still owes, but could be reached around 2012.

Summary

Japan as an insider economy traditionally featured an accounting system that was in large parts regulated by law. In this sense, it followed the German approach, which, indeed, served as a role model for the commercial code being the probably most relevant source for accounting rules. In the post-war years, the occupation forces tried to transform the Japanese business system and also intervened into accounting regulation. However, the attempts to introduce an US-oriented system of accounting regulation came to an end with the departure of the allied forces. The only heritages of the occupation forces’ reforms can be seen in the foundation of the JICPA and the existence of the Securities and Exchange Law. This, however, did not challenge the public sector’s regulatory responsibility for the policy field of accounting. The traditional accounting regulation has significantly been altered with the recent set of reforms. As an outcome of these reforms, private and international institutions gained importance. Moreover, the Japanese reforms that strengthen private solutions are in line with transformations of accounting systems that can be observed abroad. The convergence of Japanese accounting standards with IFRS further illustrates the move towards an international model of accounting regulation. Here the different ascendancies of Japanese accounting finally come together.

5 CONCLUSION

In the previous Sections, we systematically described the traditional regulatory solutions in six countries and important changes over time. This reveals the following findings: First, the six country cases examined historically relied on different governance models. Germany, France and Japan pertain to a country group that has a long-standing tradition of state dominated accounting regulation. In the 1970s these countries were generally characterised by a strong legal backing, as accounting rules were mainly set by parliaments in the form of laws. The incorporation of private actors in standard-setting was of minor relevance. Professional bodies regulated their members’ behaviour but held no further competence in accounting regulation. These countries also featured a strong interrelation between financial- and tax accounting what determined their predominant use of accounting to be payout oriented (Werner and Zimmermann 2009).

In contrast, the UK, the USA and Canada represent countries where accounting regulation originated in the private sector and remained dominated by professional self-regulation. Legal backing was traditionally low in theses countries as rules were privately set. The legal system in these countries ascribes little payout relevance to financial reports as tax and dividend calculation was performed aside (Zimmermann, Werner et al. 2008). The predominant use of accounting in these countries was the information of capital market participants.

Second, over the last decades, extreme governance models increasingly have diminished. Accounting systems with strong state reliance have incorporated private actors, to reach more effective regulatory solutions, while liberal accounting systems have strengthened the legal backing of accounting rules to provide them with legitimacy (Luthardt and Zimmermann 2009). These developments seem to be largely influenced by harmonised requirements for accounting regulations through globalised financial markets (Zimmermann and Hammermeister 2009). International competition for finance made the provision of capital market oriented financial statements become an increasingly important accounting function and today is featured in all six accounting systems. The harmonisation of regulatory needs also initiated the search for a global set of comparable accounting standards. The ongoing internationalisation of accounting standards had major impacts on most accounting systems, as international rules were adopted or mimicked in national GAAP. Convergence of the accounting systems is thus observable in all four categories and in all country cases.

Third, the country cases also reveal the structure of the convergence process showing the incremental nature and the different paths of changes in the six countries. An example for the incremental nature of the changes can be found in the inclusion of the information function in Germany and France. Starting with the implementation of consolidated accounts, the later harmonisation and formal recognition via the 7th EC directive (83/349/EEC) and finally the introduction of annual reports according to IFRS completed the process toward more information oriented accounting standards. How different paths of convergence exist, can be illustrated by the level of legal backing in the US and UK. Both countries reach similar levels of legal backing by the end of the century, but this process was initiated at distinct moments using different legal instruments. In the US, legal backing was introduced after the great depression in the 1930s using federal securities law, where it was introduced in the UK half a decade later by transforming binding EU Regulation into British company law. But different institutional environments not only affect the paths of convergence, they also determine their limits. These limitations become obvious regarding the developments of predominant uses of accounting. Convergence in this category is obvious, as the information function of accounting now comprises a predominant use in all six country cases. Still, this is only the case for consolidated accounts. Single accounts in Germany, France and Japan remain largely unaffected by harmonisation processes. Their function to determine corporate payouts is kept unaltered, together with the accounting regulations addressing single accounts.

To conclude, the entire description reveals fast changes in some areas while others only face incremental changes. The internationalisation of accounting regulation is a major event in recent accounting history. Starting from equally low levels of international coordination all countries of examination has opened up their regulatory systems to include international accounting regulations. Hence, the analysis shows big changes in the area of internationalisation. In this context it is notable, that smaller countries seem to have a stronger incentive to incline in international solutions, while larger economies rely on their accounting system with higher stickiness. The international IFRS revolution illustrates these developments. In all country cases, the IFRS are at least affecting national rule setting via convergence regulations, while in Canada international accounting standards will fully replace national GAAP in the near future. Along with this process the information function of annual accounts now constitutes a predominant accounting use in all countries. No country moved in the opposite direction and included a payout function. Still, this represents only a partly harmonised process, as also no payout-oriented accounting system dropped this function. The regulatory systems converge in so much, as all payout-oriented accounting systems gradually moved towards more information-oriented accounting. Here we observe a major barrier to harmonisation: while information-oriented accounting is provided for the economic entity in consolidated accounts, single accounts relevant for determining corporate payouts still diverge between countries of different regulatory origins. For these counties (Germany, France and Japan) a stable level of legal backing is observed pointing to ongoing differences in accountings relation to tax and company laws. Accordingly, it can be stated, that although convergence in international accounting regulation clearly is a fact, in many cases it only reaches as far, as it does not affect core aspects of the regulatory system.

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BIOGRAPHICAL NOTE

Jochen Zimmermann is Professor at the Department of Accounting and Control, University of Bremen.

Telephone: +49 421 218 9119
E-Mail: jzimmermann@uni-bremen.de

Jan-Philipp Kilian and Johannes Schymczyk are research fellows at the Department of Accounting and Control, University of Bremen.

Jan-Philipp Kilian
Telephone: +49 421 218 2458
E-Mail: jpkilian@uni-bremen.de

Johannes Schymczyk
Telephone: +49 421 218 7553
E-Mail: jschymczyk@uni-bremen.de
Address: University of Bremen, Department of Accounting and Control, Hochschulring 4, 28359 Bremen, Germany